

# MEMORANDUM

To: Blue Ribbon Commission on Tax Reform

From: Staff

Re: Update on Actions Taken by Commission – Preliminary Approval

Date: December 5, 2012

---

Dear Commission, below see the tax reform proposals on which the Commission has preliminarily voted to support:

## **Corporate taxes**

**Proposal # 12:** Add back management fees in calculation of the corporate income tax base

Revenue Score: Up to \$13 million increase to the General Fund per year.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	-	+	+	N

**Proposal # 17:** Implement single factor apportionment

Revenue Score: \$65 million loss to the General Fund per fiscal year.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
-	+	-	-	+

**Proposal # 18:** Lower the \$3.0 million LLET threshold to \$1.0 million and phase out the effects through \$2.0 million

Revenue Score: +\$14.2 million (based on lower the \$3.0 million LLET threshold to \$1.0 million and phase out the effects through \$2.0 million).

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
N	-	+	+	N

**Proposal # 19:** Establish an angel investor tax credit program for certain investments in small Businesses

(This is technically an individual income tax issue)

Revenue Score: Only \$6.5 million of the total \$40 million tax credits authorized by the Kentucky Investment Fund Act have been taken since its inception on July 15, 1998. However, over \$18 million in credits have been approved and are no longer available. While they may not have been collected by the approved entity yet, they remain allocated. The new proposal would certainly increase usage of the combined program. We are currently investigating to better understand if the changes would trigger full utilization of the capped amount.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
-	+	-	-	N

**Proposal # 23:** Use destination sourcing for services

Revenue Score: The fiscal impact is unknown, but winners and losers would be created if this proposal becomes law.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
N	+	N	Unknown	+

**Proposal # 24:** Fully decouple from the deduction for U.S. production activities (QPAI)

Revenue Score: A General Fund increase of approximately \$10 million per year will occur based on the deduction amount claimed on 2010 returns.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
-	-	+	+	+

**Proposal # 25:** Adopt a throwback rule to tax nowhere income

Revenue Score: If the throwback rule is adopted, the expected annual yield is approximately \$25 million per year.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	-	+	+	-

### **Sales and Excise Taxes**

**Proposal # 29:** Apply transient room taxes to entire hotel accommodation price

Revenue Score: An increase of \$4-5 million per year in transient room tax receipts.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	N	+	+	+

**Proposal # 31:** Broaden the sales tax to selected services

Commission urged these specific principles:

- Household consumption based
- Luxury items
- Clear destination sourcing to Kentucky
- Tied to product already taxed
- Inelastically demanded
- Be sensitive to border state sales taxes.

Revenue Score: +\$176.4 million, if using the services selected by the Report to the Governor's Blue Ribbon Commission on Tax Reform by Economic Consultants.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	-	+	+	-

**Proposal # 34:** Exempt mail charges for direct mail from sales tax

Revenue Score: A decrease in the General Fund between \$1.8 million and \$4.5 million annually depending upon how many of the direct mail components are excluded from the definition of gross receipts (postage, delivery, and handling).

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
N	+	-	-	+

**Proposal # 38:** Impose a gross receipts tax of between 1 percent on both residential and business utilities dedicated to the SEEK funding formula.

Revenue Score: Each percentage of the tax would result in a fiscal impact approximately \$90 million in extra General Fund receipts.

SCORE ON TAX REFORM PRINCIPLES				
--------------------------------	--	--	--	--

Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	-	+	+	N

**Proposal # 41:** 1) Increase collection of out-of-state and Internet sales; 2) Support federal legislation allowing states to require remote firms to collect sales tax

Revenue Score: Kentucky loses an estimated \$130 to \$200 million annually in uncollected sales and use taxes due to lack of remote vendor collection authority.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	N	+	+	+

**Proposal # 42:** Increase the tax rate on cigarettes to \$1.00 and other tobacco products commensurate to the cigarette tax.

Revenue Score:

- Raise the Cigarette Tax to \$1.00 per Pack .....\$120.0 Million
- OTP Tax Increase to 22.5 Percent .....\$8.1 Million

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
N	-	+	+	N

**Proposal # 44:** Repeal the distilled spirits case sales tax

Revenue Score: Loss to the General Fund of approximately \$100,000 per year.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	+	N	-	+

**Proposal # 45:** Restore Cigarette Rolling Papers Tax

Revenue Score: The fiscal impact of this proposal if enacted is an \$800,000 increase to the General Fund in the first year, then \$1 million per year thereafter.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance

+	N	N	+	-
---	---	---	---	---

**Proposal # 46:** Review the sales and use tax on equine products

Revenue Score: Previous proposals have been estimated to have an estimated fiscal impact of approximately \$9.5 million per year.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
N	-	+	+	-

### Property Taxes

**Proposal # 48:** Create an income tax credit for the bourbon industry to offset the property tax on stored barrels of bourbon, without reducing local property taxes to school districts

Revenue Score: \$12.9 million in the first year. The tax should grow over time as the Kentucky distillers presence is preserved.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
N	+	N	N	+

**Proposal # 50:** Exempt Inventory from property tax (state rate only on merchant's inventory, manufactured finished goods, and goods stored in warehouse), decoupled from the federal government

Revenue Score: \$4.4 million annual decrease to state revenues and a large decrease to local tax revenues. Using an estimated total local property tax rate of 120¢/\$100 of assessment, local taxing districts would lose approximately \$ 106.4 million, unless the property tax rates were raised on remaining properties to avoid the loss.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	+	N	-	+

**Proposal # 51:** Freeze the state property tax rate at 12 cents per \$100 of value

Revenue Score: Impact will be positive over time.

SCORE ON TAX REFORM PRINCIPLES				
--------------------------------	--	--	--	--

Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
N	+	-	-	+

**Proposal # 55:** Identification of public service companies for taxation

Revenue Score: Unknown increase to state and local property tax revenues.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	+	-	+	N

**Proposal # 56:** Reporting the rental space for documented watercraft/private airplanes

Revenue Score: The fiscal impact is hard to determine because it would mean putting a dollar amount to an unknown (i.e., the total value of documented boats and private aircraft that are not reported).

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	-	+	+	+

**Proposal # 58:** Remove the HB44 recall provisions for local and school real property taxes

Revenue Score: Unknown. While removing the recall provisions for local and school property tax rates definitely would make it easier to raise these tax rates, there is no guarantee that the districts would do so. There is also no way of knowing how high a district may raise a tax rate.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
-	-	+	+	-

**Severance Taxes**

**Proposal # 59:** Eliminate the export credit under the minerals severance tax

Revenue Score: Eliminating the credit will increase General Fund revenues and increase the amounts allocated to counties with limestone mines. In FY2011, the amount of credit claimed was \$2,224,700.

SCORE ON TAX REFORM PRINCIPLES				
--------------------------------	--	--	--	--

Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	N	+	+	+

**Proposal # 61:** Clarify the definition of “gross value” under severance tax

Revenue Score: receipts reduction of approximately \$3,200,000 in state revenues and \$3,200,000 in local revenues will occur on an annual basis if the definition is not clarified.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	N	+	+	+

### **Other Taxes/Issues**

**Proposal # 64:** Impose the Pari-mutuel tax on advance deposit wagers made by Kentucky residents on live races conducted at Kentucky race tracks

Revenue Score: Approximately \$2 million per year in additional pari-mutuel tax revenues are projected.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	N	+	+	+

**Proposal # 65:** (Revised) Provide for a review every five years of all tax incentives and expenditures.

Revenue Score: Not applicable.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
N	-	+	+	-

### **Road Fund Issues**

**Proposal # 68:** Raise the floor for fuels taxes

Revenue Score: No fiscal impact in the short run. Will help establish a workable base in the longer term.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity &

				Compliance
+	-	+	+	+

**Proposal # 69:** Reduce dealer's compensation on motor fuels tax from 2.25% to 1%

Revenue Score: \$17.5 million increase to the Road Fund in the first year. \$21,000,000 increase in yrs. 2 & 3.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	-	+	+	N

### **Local Taxation Issues**

**Proposal # 72:** Amend the Constitution to allow a local general sales tax

Revenue Score: -\$10 million per year.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
-	-	-	-	-

### **Simplicity, Compliance and Tax Administration**

**Proposal # 76:** Allow non-renewal of professional licenses, driver's licenses and vehicle registration if taxpayers are delinquent on state taxes to improve collections

Revenue Score: The projected fiscal impact of this proposal, if enacted, is as follows:

- 1) **Professional License Denial/Revocation** - \$250,000 General Fund increase in first full year of implementation, \$2.9 million the second year.
- 2) **Drivers License Denial/Revocation** - \$1.5 million in year two. A full year will need to be dedicated to system development. This will need to be a cooperative effort with county clerks, other state agencies including Kentucky State Police, and perhaps the Transportation Cabinet.
- 3) **Vehicle Registration Denial** - \$1.5 million in year two. At least a full year needs to be dedicated to system development. This project needs to be a cooperative effort with county clerks and the Transportation Cabinet.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	+	+	+	+



**Proposal # 77:** Amend tobacco tax laws to provide clarifications and administrative improvements enabling the Department of Revenue to better enforce Kentucky tobacco tax laws

Revenue Score: An increase to the General Fund of up to \$3 million per year can occur

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	+	+	+	+

**Proposal # 78:** Apply statute of limitations evenly to both assessments and refund claims. In particular, claims for refund based on constitutional challenges should not be singled out for discriminatory treatment by shortening the statute of limitations. Extend the number of days to protest an assessment to at least 60 days, preferably 90 days.

Revenue Score: An unknown reduction to the General Fund and Road Fund will occur.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	+	-	-	N

**Proposal # 79:** Clarify the definition of “pollution control facilities” under tangible personal property tax statutes

Revenue Score: If enacted, this proposal will prevent a loss to the General Fund of \$1 million.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	N	N	N	+

**Proposal # 81:** Define the terms “broadcast” and “telephonic equipment” in the tangible personal property tax statutes

Revenue Score: The proposal intends to save the loss of \$1,500,000 in state revenue, and \$4,000,000 in local revenue.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	N	N	N	+

**Proposal # 82:** Eliminate negligible state property tax rates for tangible personal property.

Revenue Score: Negative \$5 million to the General Fund.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	+	-	-	+

**Proposal # 83:** Eliminate the need for paper Form K-1E, Kentucky Employer's Return of Income Tax Withheld.

Revenue Score: Unknown. There will be a small cost to add this form to the electronic filing platform.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
N	+	N	N	+

**Proposal # 85:** Give multijurisdictional taxpayers a minimum of 180 days to report changes on a prior federal return at the state and local level

Revenue Score: An unknown decrease to the General Fund and local occupational tax receipts will result if tax collections are delayed. Interest would accrue during the extended period for state taxes.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	N	N	-	N

**Proposal # 86:** Installment payment agreement clarification

Revenue Score: Minimal

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
Not applicable	Not applicable	Not applicable	+	+

**Proposal # 88:** Repeal the Rural Electric Cooperative Corporation & Rural Telephone Cooperative Corporation Tax (one tax)

Revenue Score: A net gain of \$25,000 due to efficiency savings.

SCORE ON TAX REFORM PRINCIPLES				
--------------------------------	--	--	--	--

Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
Not applicable	Not applicable	Not applicable	Not applicable	+

**Proposal # 91:** Under the tangible personal property tax statutes, clarify that inventory-in-transit must be delivered to a permanent out-of-state destination in order to qualify for the under 6 month exclusion

Revenue Score: There is no way to know what property currently classified as “Inventory” will be claimed to be “Inventory-in-Transit” in the future if no change is made. By making this change, future loss of revenue will be prevented.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	N	N	+	+

**Proposal # 92:** Use tax notification and compliance requirements for remote vendors

Revenue Score: The fiscal estimate of this proposal is still under review but sales and use tax receipts could increase by nearly \$5 million annually.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	+	+	+	+

**Proposal # 93:** Return to a balanced interest rate on taxes owed to and by the state

Revenue Score: An approximate revenue loss per year of \$8 million.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
+	+	-	-	+

**Proposal # 94:** Add clarifying language in KRS 139.480(11) regarding farm machinery that specifies combine header trailers are exempt from sales tax

Revenue Score: Revenue neutral.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
N	N	N	N	N

**Proposal # 95:** Repeal the school tax rate exclusion from sales tax calculation on “residential telecommunications service” found in KRS 139.470(9)

Revenue Score: A repeal of the sales tax exclusion on the school tax portion of a residential phone bill should have a fiscal impact of less than \$500,000. Without an amendment to the sales price definition during the 2013 General Assembly, Kentucky will be found out of compliance with SSUTA thereby jeopardizing sales tax collections from SST vendors. In FY12 total collections were \$18 million, with \$10.4 million of that from voluntary sellers.

SCORE ON TAX REFORM PRINCIPLES				
Fairness	Competitiveness	Elasticity	Adequacy	Simplicity & Compliance
N	N	+	+	+